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RUEHCV/AMEMBASSY CARACAS 9043
RUEHLP/AMEMBASSY LA PAZ FEB QUITO 9999
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RUEHBU/AMEMBASSY BUENOS AIRES 2242
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STATE FOR WHA/AND, WHA/EPSC AND EB/IFD/OMA
STATE PASS USTR (BHARMAN)
STATE PASS AID (LAC/SA)
TREASURY FOR G. SIGNORELLI
COMMERCE FOR 4331/MAC/WH/MCAMERON
DEPT OF ENERGY FOR D. PUMPHREY/ GARY WARD/SARAH
LADISLAW/MANOLIS PRINIOTAKIS
DEPT PASS TO INT/USGS/RESTON FOR DMENZIE/AGURMENDI

SIPDIS

E.O. 12958: N/A

TAGS: ECON EFIN EINV ETRD ENRG SOCI PGOV PE
SUBJECT: PERUVIAN ECONOMY FIRING ON ALL CYLINDERS

1.(U) Summary: the Peruvian GDP expanded by 6.3 percent -- the fastest rate since 1997 -- and topping economists' earlier estimates. Investment and exports were the primary engines of growth, but the expansion was broad-based, with important sectors, including mining, agriculture and non-primary manufacturing, also expanding. The inflation rate was a low 1.5 percent, at the Central Bank's targeted floor. Poverty is receding, particularly in areas with strong exporting industries. Analysts predict that the economy will continue to expand in 2006 and beyond, even if there is a slow down in the global economy. Much depends, however, on the upcoming presidential elections. End Summary:

Strong Growth -- Low Inflation

2.(U) Peru's economy grew significantly for the fourth consecutive year, expanding 6.3 percent in 2005, according to the Ministry of Economy and Finance. The strong expansion was driven by surging exports, which grew 33 percent year-on-year to \$17 billion. Despite the rapid economic acceleration, inflation was maintained at the Central Bank's targeted floor, 1.5 percent. The rising economy lifted tax collections by 16 percent, contributing to a manageable budget deficit of 0.6 percent. Strong export growth has created a record high trade surplus, \$4.3 billion, and high international reserves, \$14.1 billion. Investment was up 11 percent.

Exports Leaping and Bounding

3.(U) Propelled by a favorable global economy, Peruvian exports have more than doubled since 2002, according to the Ministry of Commerce and Tourism. The United States continued to be the principal destination for Peruvian products, taking in \$5 billion of Peruvian exports in 2005, a 37 percent jump over 2004. China has emerged as the second biggest market, importing nearly 11 percent of

Peruvian products (\$1.8 billion), about 50 percent more than the previous year.

¶4. (U) Mineral exports, driven by record prices and higher production, expanded by 33 percent to \$9.4 billion in 2005. As a result, minerals' share of overall Peruvian exports rose slightly to 56 percent of the total. Other sectors such as apparel and textiles saw substantial growth in 2005, even as international competition stiffened. Apparel and textile exports surpassed \$1.2 billion, a 16 percent increase over 2004, despite the turbulence created by the removal of U.S. and European quotas and the surge in Chinese exports to those markets. The boom in apparel exports is a direct result of the Andean Trade Promotion and Drug Eradication Act (ATPDEA), which entered into force in 2002.

¶5. (U) Agricultural exports jumped an impressive 27 percent in 2005 to \$1.4 billion, according to the Ministry of Agriculture. Coffee was the leading agricultural export (\$306 million), but non-traditional products made up three-quarters of all agricultural shipments. Asparagus exports increased 11 percent, paprika exports grew by nearly 90 percent and artichoke exports doubled. The diversification of agricultural exports is particularly good news for the Peruvian farm and livestock industries, as they prepare to compete in the post-free trade agreement economy.

Another Good Year for Mining

¶6. (U) The Peruvian mining industry benefited from record high prices and increased production in some sectors. Gold production jumped 21 percent to 210 million metric tons in

¶2005. Gold exports were up 25 percent to \$3 billion. The price of molybdenum jumped a remarkable 1,300 percent between 2001 and 2005. As a result, molybdenum concentrates exports soared from \$32.9 million in 2003 to an estimated \$1.2 billion in 2005. Copper production was down, but higher prices led to a 27 percent rise in the value of exports to an estimated \$3.1 billion.

¶7. (U) Natural gas production jumped 76 percent to 146.2 million cubic feet per day in 2005, the first full year of production of the large Camisea facility. Crude oil production continued its downward trend as reserves decline.

Homegrown Growth

¶8. (U) Private consumption, which had been growing at about 3.5 percent for the last four years, rose an estimated 4.5 percent in 2005. Construction rose an estimated 6.3 percent, spurred by a GOP housing construction program, road construction and the proliferation of shopping malls. Manufacturing was up 6.3 percent. Private investment, driven in part by investment in mining production, housing and highway construction, grew by an estimated 11 percent. Peru's tourism sector increased an estimated 20 percent in 2005 to 1.4 million tourists, generating around \$1.4 billion in revenue.

Poverty Reduction Starts to Pick Up

¶9. (U) The four successive years of substantial economic growth appear to be making a dent in the high unemployment and poverty rates in Peru. The unemployment rate in Lima declined to 7.6 percent in December 2005, the lowest level since 2001, while underemployment declined to 54.7 percent in the fourth quarter. The Ministry of Economy and Finance estimates that the poverty level declined nearly 12 percent between 2001 and 2005, from 54.3 percent to 49.5 percent. The Ministry also estimates that extreme poverty -- those living on about a dollar a day -- declined 25 percent over the same period, from 24.1 percent to 18 percent.

¶10. (U) Analysts both in and outside the government predict continued economic growth in 2006 of around 5 percent. The Ministry of Commerce and Tourism believes that exports will top \$20 billion in 2006. Private investment is expected to grow 8 to 9 percent. Local economists expect inflation to remain within the Central Banks range of 1.5 to 3 percent.

¶11. (U) Economists and investors are taking a cautious approach to the Peruvian economy because 2006 is an election year. The emergence of the ultra-nationalist, anti-system candidate Ollanta Humala as a front-runner caused a wave of anxiety among businesses and a brief drop in the stock market. Humala's economic policies are not yet fully known, but he has made several anti-investment comments, such as limiting Chilean investments in Peru, and he has publicly aligned himself with Venezuelan President Chavez and the newly elected Bolivian President Morales. Post will report shortly on the economic policies of Humala and the other front running candidates.

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